

of the taxable year in which such timber is cut and such value shall be considered for such taxable year and all subsequent taxable years as the cost of such timber for all purposes for which such cost is a necessary factor. See section 631(a).

(c) *Cross references.* In cases where the valuation, revaluation, or mineral content of deposits is a factor, see paragraphs (c), (d), (e), and (f) of § 1.611-2. In cases where the valuation, revaluation, or quantity of timber is a factor, see paragraphs (e), (f), and (g) of § 1.611-3. For definitions of the terms *property*, *fair market value*, *mineral enterprise*, *mineral deposit*, and *minerals*, see paragraph (d) of § 1.611-1. For rules with respect to treatment of depletion accounts on taxpayers' books, see paragraph (b) of § 1.611-2 in the case of mineral property, and paragraph (c) of § 1.611-3 in the case of timber property.

§ 1.612-2 Allowable capital additions in case of mines.

(a) *In general.* Expenditures for improvements and for replacements, not including expenditures for ordinary and necessary maintenance and repairs, shall ordinarily be charged to capital account recoverable through depreciation deductions. Expenditures for equipment (including its installation and housing) and for replacements thereof, which are necessary to maintain the normal output solely because of the recession of the working faces of the mine and which:

- (1) Do not increase the value of the mine, or
- (2) Do not decrease the cost of production of mineral units, or
- (3) Do not represent an amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made shall be deducted as ordinary and necessary business expenses.

(b) *Special rule.* For special provisions applicable to treatment of expenditures for certain exploration and development costs (other than for the acquisition, restoration, or betterment of improvements) with respect to minerals other than oil or gas, see sections 615 and 616 and the regulations thereunder.

§ 1.612-3 Depletion; treatment of bonus and advanced royalty.

(a) *Bonus.* (1) If a bonus in addition to royalties is received upon the grant of an economic interest in a mineral deposit, or standing timber, there shall be allowed to the payee as a cost depletion deduction in respect of the bonus an amount equal to that proportion of his basis for depletion as provided in section 612 and § 1.612-1 which the amount of the bonus bears to the sum of the bonus and the royalties expected to be received. Such allowance shall be deducted from the payee's basis for depletion and the remainder of the basis is recoverable through depletion deductions as the royalties are thereafter received. (But see paragraph (e) of this section.) For example, a taxpayer leases mineral property to another reserving a one-eighth royalty and in addition receives a bonus of \$10,000. Assuming that the taxpayer's basis with respect to the mineral property is \$21,000 and that the royalties expected to be received are estimated to total \$20,000, the depletion on the bonus would be \$7,000:

$$[\$21,000 \text{ (basis)} \times \$10,000 \text{ (bonus)}] \div \$30,000 \text{ (bonus plus estimated royalties)}.$$

The remaining \$14,000 of basis will be recovered through depletion as the royalties are received.

(2) If the grant of an economic interest in a mineral deposit or standing timber with respect to which a bonus was received expires, terminates, or is abandoned before there has been any income derived from the extraction of mineral or cutting of timber, the payee shall adjust his capital account by restoring thereto the depletion deduction taken on the bonus and a corresponding amount must be returned as income in the year of such expiration, termination, or abandonment.

(3) In the case of the payor, payment of the bonus constitutes a capital investment made for the acquisition of an economic interest in a mineral deposit or standing timber recoverable through the depletion allowance. See paragraph (c)(5)(ii) of § 1.613-2 in cases in which percentage depletion is used.

(b) *Advanced royalties.* (1) If the owner of an operating interest in a mineral deposit or standing timber is required